

Exercise 7a. Crowder's Jewelry Store Case Study

Introduction

The meeting was set for 3 p.m. on March 10, 2001, in the office of Sally Hornbein, a downtown lawyer. As the meeting participants began to arrive, the atmosphere became charged with anticipation. Mr. Reynolds, with his lawyer by his side, sat down and started looking once more through the stacks of papers in front of him. He wanted to make sure every detail was right. He had dreamed of owning a retail business for many years, and it could become a reality very soon. Mr. Crowder, an elderly gentleman, walked slowly in, greeted Ms. Hornbein, his lawyer, and looked nervously around the room. He had a right to be nervous; he was perhaps about to sell a big part of his life.

Store history

Crowder's Jewelry Store was started 25 years ago by Mr. Crowder, now age 72. This retail jewelry store has been operating in a suburban shopping center for the past 10 years. This has proven to be a very good location, since it is located in a well-established, affluent neighborhood. The store has a five-year lease in the present location at 6 percent of volume and two five-year options at no increase. Many of the customers have been shopping here for years, and Mr. Crowder has a very good reputation with his clientele. The store has a computer database of all its customers (name, phone number, past purchases, spouse's name, and the like.). The store is very attractive, having been remodeled about three years ago. The company owes a note of \$20,000, with 10 percent interest on these improvements.

Crowder's Jewelry has always been operated as a family business. Mrs. Crowder occasionally helped in the store while raising their daughter, Alice, who worked there summers as a teenager and full-time until her marriage to Bill Roberts. Bill, Mr. Crowder's son-in-law, works in the store as a jewelry designer. He usually puts in about three days per week and sets his own hours.

Mr. Crowder has been having health problems, with high blood pressure and a heart condition. His doctor has advised him to retire from the business. Mr. Crowder reluctantly has put the business up for sale.

The buyer

Mr. Reynolds, age 42, heard about the jewelry store for sale through his accountant, who also does the books for Mr. Crowder. Mr. Reynolds has been designing and manufacturing fine jewelry as a hobby for the past 20 years. He presently is subcontracting the manufacturing and wholesales his designer jewelry to a few upscale jewelers nationwide. He has been thinking of expanding his hobby into a full-time business by opening a retail location so he can sell directly to the public at a high markup.

He has \$100,000 in cash, does not own a house but has a good credit rating.

Mr. Reynolds has been doing research on Crowder's Jewelry to determine the feasibility of buying the business, the market potential of continued and growing sales and the value of the firm. Both he and his accountant have examined the financial statements. Mr. Crowder strongly hinted that he has been taking about \$30,000 in cash out of the business per year without reporting that sum to the IRS.

Mr. Reynolds believes that, with good advertising, lower prices and good financing, he can increase sales to \$1,500,000 in the existing location.

To become more comfortable with the true value of the assets of the company, Mr. Reynolds hired Jacobsen's Appraisals to analyze the assets and to give him a report on current market values of the assets. Here is a copy of the report Mr. Reynolds received.

**Asset Appraisal
Statement of Value
February 28, 2001**

Accounts Receivable

Accounts receivable	\$92,000
Less: Estimated uncollected A/R	(15,000)
Net accounts receivable	<u>77,000</u>

Inventory

Inventory	\$400,000
Less: Estimated obsolescence	(15,000)
Net inventory	<u>385,000</u>

Property, plant, and equipment

Office equipment	\$14,500
Computer equipment	8,300
Furniture	5,400
Vehicles	24,000
Leasehold improvements	0*

A research of all liabilities of the company found the following:

Accounts payable	\$70,000
Notes payable	20,000
Taxes payable	8,500**

Note: All other payables including the notes payable and wages were paid through the end of the month of February.

* The lease agreement stipulates that all improvements made to the property by the lessee are forfeited at the end of the lease when the property is transferred back to the lessor.

** A tax liability was discovered during a review of the prior three years of tax returns.

Crowder's Jewelry Store
Balance Sheet
February 28, 2001

Cash	\$30,000	Accounts payable	\$70,000
Receivables	92,000	Notes payable	<u>20,000</u>
Inventory	400,000	Current liabilities	90,000
Current assets	<u>522,000</u>		
		Owner's equity	<u>547,000</u>
Fixed assets	<u>115,000</u>		
Total assets	\$637,000	Total liabilities and owner's equity	\$637,000

Crowder's Jewelry Store
Income Statement
Years ending December 31, 2000, 1999, 1998

	2000	1999	1998
Sales	\$950,000	\$1,030,000	\$1,150,000
Gross margin	437,000	463,000	529,000
Expenses	304,000	350,200	391,000
Pre-tax profit	133,000	113,700	138,000
After-tax profit	93,100	79,590	96,000
Mr. Crowder salary and expenses	70,000	60,000	50,000
Bill Roberts salary and expenses	40,000	35,000	30,000